BNZ Weekly Overview

23 November 2017

ISSN 2463-4328

Mission Statement

To help Kiwi businesspeople and householders make informed financial decisions by discussing the economy and its implications in a language they can understand.

Long-Term Farming Challenges

Lets stand back from the immediate fray this week and consider some of the long-term factors which businesses, investors, policy makers etc. should be thinking about.

Lets start with the traditional backbone of the NZ economy – farming. This is a sector which has always undergone change and adaptation to movements in market prices, rules and regulations, pests and diseases, market access requirements, the emergence of competitors and so on. People enter the field of farming knowing that they're not going to be doing the same thing in five, ten or forty years time as they are doing now or were doing some years back.

In the past the biggest macro-challenge facing farmers was market access. They lost a lot of it when the UK joined the EEC back in 1973. They have been strongly supportive of government efforts (Labour and National) to sign trade agreements giving better access for primary products into markets which have been protected for domestic political and social reasons.

Going forward market access is not going to be the big problem facing our primary producers. Instead there are two big challenges – environmentalism and protein alternatives. By the latter we mean vat grown milk, factory grown meat, and plant based proteins replicating meat.

The environmental factor has always been there and apart from a few dirty operators farmers have long shown a concern for the environment and their impact on it. But the strong growth in dairying these past two decades has brought a negative environmental impact on water quality and greenhouse gas emissions which has never before been there.

Farming is still excluded from the Emissions Trading Scheme and will remain so courtesy of the demands of NZ First for this parliamentary term. But that cannot continue. With global climate change seemingly accelerating farming will have to be brought into the scheme and farmers should be prepared for the cost of buying emissions rights becoming higher than it currently is if the effects of climate change become more obvious and damaging and global determination to do something about it soars.

Farmers need to be planning now for more than just extra funding for various research institutes to try and find lower-emitting animals. And they will need to do more than finance advertising campaigns and open their gates to show us their land. Changes in the types of animals they rear, how they graze, what they eat, how many they stock etc. need to be scenarios which farmers run in their heads and perhaps computers now.

The dairy sector is going to experience the biggest need for change not just because it has grown near unfettered apart from a few locations. It's negative effects are more obvious than for other farming activities. Few people blame dirty rivers on sheep – some on beef cattle, almost all on dairying.

The issue for farmers is that the pressure for them to stop polluting NZ water comes not just from average Kiwis but the growing tourism sector. By one measure receipts from foreign tourism now exceed receipts from dairy exports. This translates to jobs (more of them from tourism than dairying ever approaches) and political power. A shift in that power is underway.

Tourism operators sell NZ as clean and green. But that image is wrong and becoming increasingly so. Reversing the slowly growing concern about degradation of the tourism product will become manifest as pressure from the tourism sector on policy makers to accelerate changes in dairying.

The ultimate outcome of this is going to be fewer cows in New Zealand. Peak cow. This will result from a range of sources.

One will be reduced stocking rates from lesser application of nitrogenous fertilizers which leak into water systems. Grass will grow less rapidly. Another will be reduced feeding out of supplementary food. Helping drive these changes will be the spreading of regulations limiting farm nitrogen levels and leakage.

It is possible that in some parts of the country excess milk processing capacity will eventually exist. It is reasonable to expect that there will be a land price impact from soon to be falling forward projections of likely income off dairy land in the next decade. It is reasonable therefore to also expect reduced availability of debt. And it seems reasonable also to expect that eventually, just as banks in Australia have in some cases made the decision not to finance new coal mines, there will be recommendations made to ease off on funding of dairy farms which do not meet the highest emissions and water polluting standards. Coal pollutes, so do cows.

We are not there yet. But the direction of things is abundantly clear.

The other writing on the wall screams in very big letters – ALTERNATIVES.

Already plant-based chicken product is available in New Zealand. Over time it will become much cheaper and chefs will develop recipes which take advantage of whatever properties it has which differ from real dead animal flesh.

Making “meat” from plants is just one threat to the sheepmeat, beef, chicken and venison sectors, and it is not a linear threat. That is, we will one day reach a tipping point whereby eating real flesh will be socially frowned upon and allocation of chiller space in supermarkets will undergo a seismic shift from meat to the alternatives. Again, we are still well away from that happening.

The other threat to both meat and milk is factory produced alternatives. For meat it will be actual meat grown on some sort of mesh not involving an actual animal. No head, no digestive system etc. For milk it will be more than what is already happening with the likes of soy and almond “milk”. It will be real milk made without the involvement of a cow. No waterway pollution. Few emissions. No need for vast tracts of land.

Again, this is not something imminent. But it will come. And it seems overly dismissive to assume that we in NZ will comfortably adjust to the factory and plant-based alternatives by shifting up-market to target those people who are prepared to pay high prices for the “real” thing. We are clever, but we’re not special to the world.

Timeframe for these things? Starting now, starting small, slowly changing policies, but canny long-term investors moving into the alternatives. Maybe 20 years? Same timeframe as driverless cars? Who knows? Hopefully the change when it comes will not be as sudden and as economically negative as that for coal and the West Coast of the South Island. And consider wool. Merino is going gangbusters. But typical NZ coarse wool remains in low demand globally. Not all sheep farmers can shift “upmarket” to Merino.

What should farmers do to prepare for the effects on their operations and land prices long term of environmentalism and cheap alternatives? First, plan to get debt down long-term. Second, continue to do what you have always done which is to change at the margin. Small changes over time rather than big debt-funded makeovers. Tourism-related ventures. Agroforestry. Nuts. Crops. What inputs will the alternative protein companies need?

And the key point to note is this. Winston and politicians like him won’t always be there to protect you as he has done through to 2020. Your political power is strong but it is waning in the face of the increasingly obvious environmental negatives. Slowly change what you do, not the image presented by branding “gurus” on your behalf on TV.

Social and Economic Mobility

My original title for this little section of commentary was the usual Housing. But what it discusses is housing cost as an impediment to the functioning of a key element of the Kiwi lifestyle and of our values. The ability to break away and get ahead by moving on and moving out.

There is a shortage of houses in Auckland which is going to get worse. With bobbles along the way prices will oscillate upward with a new official upward leg to the price cycle in maybe four or five year’s time. Lets say associated with the Americas Cup and APEC meeting in 2021 for want of anything better to build this cyclical point around.

Rising prices eventually also bring rising rents. This is happening in Wellington with extra pressure expected from the new government doing what they normally do and hiring lots of advisors, cardigan-wearers and busy bodies using taxpayer money to tell you how to live your life. Then raising taxes to pay for it.

Rising rents in our big cities will also be driven by rising landlord costs and falling rental supply from policies making it less attractive for people to buy or hold a property for rental purposes. Extending the brightline test, housing warrants of fitness, ring-fencing cash losses, extra tenant protection and so on.

We Kiwis are highly mobile both internally and externally. Most of us believe and expect that if someone truly wants to get ahead they can easily do so by shifting from where they are and taking advantage of the education options on offer (improving under Labour) without the crunch of funding their own healthcare in most instances. (I mention this as I am currently reading Joe Bageant's book "Deer Hunting With Jesus" discussing the gun-toting, Trump-voting poorly educated white underclass of some 40 million in the US bereft of health access yet fully buying into a self-reliance system (no socialist universal healthcare) and a belief that if even fresh immigrants can make good anyone struggling has only themselves to blame).

We don't tend to accept that if someone is born in a particular location they are condemned to stay there forever. But internal mobility is being impeded by soaring big city housing costs. One outcome is likely to be subsidised housing for core people such as teachers, police, nurses etc. But another outcome is going to be some more young people moving to Australia for more affordable accommodation – maybe Brisbane and Perth.

This won't be a flood, and it won't see us soon back at the net Trans-Tasman loss of 40,000 seen in 2012. But it will help continue the turning of the net migration flow with Australia which started about a year ago when the net gain peaked just below 2,000. Now it is a small net annual loss of just under 100.

If I Were A Borrower What Would I Do?

Nothing new. I would seek a mix of 1 – 3 years noting that there is currently some discounting of two and three year rates going on. Going beyond three years I personally would find too expensive in the absence of any solid evidence that the global or local inflation track is set to move decisively upward and prompt some severe tightening of monetary policies by central banks.

Sorry savers and retired investors. There really is no serious hope currently that you will be receiving 5% term deposit rates for short lock-ins in the next couple of years.

The Weekly Overview is written by Tony Alexander, Chief Economist at the Bank of New Zealand. The views expressed are my own and do not purport to represent the views of the BNZ. **This edition has been solely moderated by Tony Alexander**. To receive the Weekly Overview each Thursday night please sign up at www.tonyalexander.co.nz
To change your address or unsubscribe please click the link at the bottom of your email. Tony.alexander@bnz.co.nz

This publication has been provided for general information only. Although every effort has been made to ensure this publication is accurate the contents should not be relied upon or used as a basis for entering into any products described in this publication. To the extent that any information or recommendations in this publication constitute financial advice, they do not take into account any person's particular financial situation or goals. Bank of New Zealand strongly recommends readers seek independent legal/financial advice prior to acting in relation to any of the matters discussed in this publication. Neither Bank of New Zealand nor any person involved in this publication accepts any liability for any loss or damage whatsoever may directly or indirectly result from any advice, opinion, information, representation or omission, whether negligent or otherwise, contained in this publication.